Metro Bank Announces Successful Capital Package

Transcript of Investor and Analyst Presentation

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Daniel Frumkin (CEO) and James Hopkinson (CFO)

Daniel Frumkin, CEO

Good morning, everyone. Thank you so much for joining the call. I really appreciate you taking the time. I know the announcement got out a bit later last night than we were expecting, but I'm really glad you've had a chance to digest it and I look forward to spending some time with you this morning. So, listen, I think we need to back up to what we've always said about Metro since the time I joined. It is a great franchise. It does a phenomenal job at looking after customers and growing deposits, current accounts, business current accounts. It continues to deliver for our colleagues, our communities, and ultimately our customers.

I think if we go back to what we said at the half year, without wanting to be too repetitive, you'll see the first slide in the slide deck on slide three, the strategic pillars. I want to be really clear that we have delivered everything we said we were going to do, and we've positioned Metro in a unique position, as you can see on the chart on the right on this slide. It differentiates us from everybody else in the UK, be it another monoline challenger or a full service high street bank. Our funding advantages and our ability to generate assets, in a diversified way, means that Metro has an opportunity to grow and generate meaningful returns. What we said at the half year on this slide is we just needed more petrol. We needed a bit more fuel for the tank. This is it. This capital raise positions metro to leverage up the foundations it has built and allows us to drive the business forward.

If you turn to the next slide, the famous tick mark slide, the reality is that we are well positioned across an array of asset classes, a truly full service financial institution. And we can now start to leverage up those abilities for the benefit of all stakeholders. And then if you go on to the next slide on slide five, as we talked about at the half year, we have a unique opportunity to grow our deposit franchise by introducing new products into our array of existing products. As I said at the time, we had a very limited product set as an institution. So at the moment our cash ISA product is not digitally enabled, it's not straight through processing, and we don't take advantage of the switcher service. In both retail easy access and business easy access we have a single account. It doesn't give us the flexibility to reward those most loyal and those most committed to supporting the bank. We're in the process of building those products out and would hope to be in a position to launch them by early next year. And if we can simply get to our existing market share for personal or business current accounts, we would generate the thick end of £15 billion of incremental deposits over time. That doesn't even account for other products we'll introduce over time or other growth we would expect to receive. So again, Metro has always been well positioned to grow and deliver good returns. The missing link was the capital. This fills that need.

Now turning onto the specificity on the next slide of what we've done in the last few days. We've secured £325 million of new capital. £150 million of that is new equity, mainly provided by existing shareholders. We've also secured £175 million of new MREL. At the same time of doing that, we thought it prudent to refinance the existing £600 million of debt. The refinance of the £600 million of debt has bought Metro not only time, but additional resources to grow in the market. And as we have informed the market, we are also considering a £3 billion mortgage sale that should complete this year. The mortgage sale is not dissimilar to what Metro did three years ago when we did what we affectionately call internally as Project Eden, when we sold £3 billion of residential mortgages to NatWest to reposition the balance sheet to allow for further growth, higher margin lending and improved profitability. The mortgage sale, depending upon pricing, makes a lot of sense for the exact same reasons. The mortgages we have on our balance sheet are high quality but aren't necessarily what we want on our balance sheet as we move forward, they're probably better placed on another institution's balance sheet. As I've said, this package gets us out of our combined buffers. That is a major accomplishment and gives us the room to stretch our legs. Based on the 30 June numbers, the proforma CET1 would have been over 13% and the MREL ratio in excess of 21.5%. And as I've said before, the refinancing means that all our MREL Senor Instruments aren't due until 2028. So we have petrol and time. Those are two resources that were quite limited at Metro and constrained our strategic optionality. Now that we have capital and time we can drive the business forward in an extremely accretive manner. We're looking forward to growing the business over the coming years. We've also provided guidance that we had not provided previously. So we expect in 2025 to have a ROTE in excess of 9% and then growing to low double digit to mid-teens thereafter over the medium term. So I just want to make sure everybody really understands that what we are saying is this bank is profitable, will be profitable and its profitability will grow. We also have provided guidance for 2024 of a mid-single digit ROTE, which we believe is deliverable if we deliver on the plans we've outlined in this document. And again quarter three on an after tax basis was profitable again. It's the fourth quarter in a row where we saw profitability and we continue to see personal and business current account growth. And to be clear, even over the last handful of days, we saw new accounts being opened.

Let's get in a bit more detail on slide seven of the capital package overview. I'm not going to spend a lot of time on this. I'm happy to take questions there's a fair amount of detail in here. I think you can read it at your leisure and go forward. What I would say is the equity raise was supported by the majority of our shareholder register, and we were happy for that support. I think the investment we got in was completely aligned with Metro being Metro and the folks who continue to support us completely believe in the model and completely believe in the prospects for Metro going forward. I think they all realised the missing ingredient was a bit more capital and they were happy to provide it. In terms of the debt refinancing, we managed to obtain £175 million more of MREL resources that again helps us grow. I'm not going to spend a lot more time on that slide because I think we've covered that on the prior slides.

So if you go on to slide eight. There's a bit of additional guidance so that everybody has an understanding. Loan growth, we expect asset rotation as we did post the original mortgage we did, that mortgage sale will allow us to continue to rotate assets, as will the additional capital. We are focussed on continuing to grow our specialist mortgage business and really start to grow our commercial lending business again. Our commercial lending business has been really constrained over the last few years due to the capital, and it's an area where between our regional commercial, our corporate and our SME lending franchises, we are very confident in our ability to grow share in a very accretive way. The loan book will obviously contract in 2023 if we sell the loan book, I mean if we sell £3 billion of loans obviously it will contract, but we expect double digit compound annual growth rates between 2024 and 2028 in loan growth as we stretch our legs in commercial lending and specialist mortgages. The funding, again, we will fund the balance sheet through native activities. We fully anticipate to be able to grow deposits quite quickly in 2024, followed by a mid-single digit growth in 2025 and 2026. I will say it's an area that I would hope to outperform over time, but we need to get the products built, get them launched and understand how quickly we can get the growth in. But again, for us, going back to the first slide, we’re uniquely positioned where our funding model gives us a huge competitive advantage. We expect NIM to grow. We would hope NIM starts to approach 3% by 2026. Again, we don't hedge our mortgage portfolio, so some of the banks who have had a hedge in place have probably shown more NIM expansion due to the value of the hedges. We naturally hedge. So as the mortgage book rolls off and our investment portfolio rolls off and we reinvest in at higher yields, we get natural NIM expansion. In addition, as we now have the capital to really go after commercial and corporate lending, those are significantly NIM accretive activities. You will see in the RNS that we were very clear that we need to reduce cost by £30 million. I want to be clear though, that that is not £30 million down year on year. That is £30 million down on the 2024 forecast that investors saw as part of the capital activities. And we expect cost income ratio to continue to improve both through our cost actions and as we leverage up the fixed cost base of Metro. And again, in case you missed it, we put it in red to make it really clear, we expect a ROTE in excess of 9% in 2025 and we will be a double digit ROTE organisation thereafter, growing into mid-teens in the medium term. There is nothing wrong with the Metro business model. It has a huge potential to deliver for all stakeholders. And with the capital we've just obtained, we are very confident in where we go. In terms of the capital, again, I think those are there for you to be able to model. The timetable and conditions of the capital, we expect to issue a prospectus and a shareholder circular in the next few weeks. We expect to complete by quarter four 2023 but obviously conditions of the capital package, that's what happens when you let lawyers draft a slide, I think there's a couple of bits you need to know more than anything else. Of the debt, we had a 100% support from all debt holders, both in the Tier 2 and on the Senior, of the ones we could find. So that equals a little over 74% after trades are settled this week for both instruments and so we're within 100 basis points of the 75% needed to be able to compel those refinancing. So we're very confident in our ability to deliver that. We've been very engaged with the shareholder base, obviously, over the last stretch, and we're confident in our ability to get to the 75% needed to enact the transaction. We think we have delivered a transaction that is meaningfully superior to any alternative, for all stakeholders. And we would hope the benefits of the transaction are self-evident. And therefore we're confident in the support.

And then lastly, just because I like to be a bit repetitive, on slide ten we're going to end where we started with the right hand box. Metro Bank is uniquely positioned because it has a funding model that is differentiated and asset generating capabilities that are diverse. We are not a monoline and we fund ourselves like a high street bank. We just need to be bigger. And we now have the capital to do that. And with that, I'm happy to take questions. Thank you.

Conference Call Operator

Thank you very much. We will now enter our Q&A session. As a reminder, if you would like to ask a question, please press star followed by 1 on your telephone keypad. If you change your mind and would like to revoke your question, please press star followed by 2. When preparing to ask your question, please ensure that your device is unmuted locally. Our first question comes from Grace Dargan from Barclays. Grace, your line is now open. Please proceed with your question.

Grace Dargan, Barclays

Hi. Thank you. Good morning. Thank you very much.

Daniel Frumkin, CEO

Morning, Grace.

Grace Dargan, Barclays

And so I guess a couple from me if possible. So firstly, to what extent are you prepared to move back into your capital buffers and would you be prepared to do that across the stack? Kind of what's the conversation been like with the PRA regarding that? And then secondly, on the potential kind of asset sale, so note the commentary around being capital accretive in 2024 and kind of beyond. Are you trying to tell us something around the potential discount you'd be willing to absorb there maybe something around kind of 5% to 10%? And is that realistic kind of given where the portfolio is sitting? And I guess would you also consider further portfolio sales or how are you thinking about that? Thank you.

Daniel Frumkin, CEO

Listen, Grace, two really good questions, although I find the first one quite hurtful, just because we haven't, you know, I just got out of buffers, at least let me have a day. Listen, we haven't really contemplated going back into buffers. You can assume that the five year plan that we've created over the last few days has been reviewed in detail with the PRA as part of this, as it has been with potentially new and existing investors as they contemplated whether they would move forward. We become quite capitally accretive Grace, I mean, you know, if we're generating, you know, upper single digit, low double digit mid-teens return on tangible equity, actually you would assume that that would build capital over time. So I think that's probably the best answer I can give you. But, you know, I had a little bit of PTSD there, so let's not talk about that anymore because I'm quite glad to be out of buffers. In terms of the asset sales, we've been really clear that we will treat the balance sheet in the best interests of all stakeholders and we will trade in and out of assets when we think it's appropriate. Yes, I would say a 5% to 10% discount on the mortgage sale is significantly outside anything we would consider. I think the book and the yield on the book and the quality of the book will not require that. I think you're off by a pretty significant magnitude, even at the 5%. I think if you cut the 5% in half, you might be sneaking up on it. The reality is, is that there is a way for that maths to work, but we think actually the book is good quality. Fundamentally, given the fact that we're still a standardised bank after the recent headlines, those assets we're selling are probably better off on a bank's balance sheet that has AIRB. Yes. So in essence, they're mortgages we put on our balance sheet in anticipation of gaining AIRB, now that that is unlikely in the near term, then the reality is, is that they're better off on somebody else's balance sheet. We think they will pay us for them and we'd rather redeploy that capital and that liquidity into different earnings classes. In terms of whether we sell other portfolios. You know, Grace, I'm not wedded to anything. If somebody wants to pay me a price that I find attractive, that I can then redeploy the capital and make more money for all stakeholders then I would sell the furniture. So I will do whatever it takes to drive the business forward. The beauty of it is now that we have additional capital and that we actually have the petrol we need, you know, the business can really stretch its legs across a lot of vectors and we're very excited about the prospects. Thank you.

Grace Dargan, Barclays

Thank you very much.

Conference Call Operator

Thank you. Our next question comes from Perlie Mong from KBW. Your line is now open. Perlie, please go ahead when you're ready.

Daniel Frumkin, CEO

Hey Perlie.

Perlie Mong, KBW

Yes. Another two questions. Oh, and congratulations for the capital raise, I'm sure it’s a relief for you, I guess two questions from me. One is I don't know whether I'm missing something, but you talk about a £200 million capital increase from the package, but the new equity is £150 million and I guess the benefit you get from the liability management of the 40% haircut is £100 million, so I just struggle to get to a £200 million benefit. So if you could help me with that, that would be great. And secondly, on I guess just some of the assumptions you have on the loan growth, because a 10%, well I guess more than 10%, like a double digit CAGR in specialist mortgages and commercial feels quite ambitious in the current environment when obviously mortgages are not growing across the sector and commercial lending, well I guess especially SME lending, has been falling for coming to 29/ 30 months now. So I guess just what assumptions are you making around the growth?

Daniel Frumkin, CEO

Okay, great. So listen, I'll give a quick answer on the £200 million then I’ll let James give a little bit more detail. So you're right, it's £150 million of common and £100 million of debt discount. You do need to remember the debt discount has a bit of a tax hit to it and there’s obviously a bit of cost to get here, but we’ll let James come in and give you a bit more detail. But I think those are the two things you need to think of. And also we wanted to be a bit conservative in the numbers we provided. In terms of loan growth, we are actively not accepting certain loan applications because we have been capitally constrained in our commercial and corporate business. We have seen limited, to very limited effect of interest rate rises and COVID and everything else on our corporate and commercial loan book because it's extremely well underwritten, really well collateralised. We have teams of very experienced, very seasoned corporate and commercial lenders who have not been able to attack the market the way they would like. If you go back in time, the amount of loan volume we need to generate in corporate commercial, while above, is not significantly above what we were doing pre the 2019 issues. So we're pretty confident in that space. In terms of our specialist mortgage space, I mean, the gentleman who runs our mortgage business, who I have a ton of time for, he does a great job, Charlie. I mean, he used to run distribution for Kensington mortgage corp. The gentleman who runs products and commercial for me in the mortgage space used to be at OSB. We probably know the specialist mortgage business better than we know the prime residential business. We're very convinced, given the contacts we have in the marketplace, in our ability to generate significant volumes. In terms of processing those volumes, those volumes would still be below what we did about a year ago, 15 months ago in mortgages, when we really stretched our legs for a period of time. We've also just put in a new platform that will allow us to introduce some scoring technology and some other things to automate and a little bit more straight through processing to free up capacity of underwriters. So we're pretty confident, I don't want to say overconfident, but we're really confident in our ability to grow those asset platforms. And then, James, if you would just come back to the capital.

James Hopkinson, CFO

Well, I mean, I think you answered that incredibly well, and just to reiterate what you said, we wanted to be conservative in how we modelled it. We have assumed a full tax charge against the gain on the Tier 2 haircut, and also there are issuance costs associated with all of the transaction. So I think that's the way to think about it. If we can deliver that, then great. And then on the asset side as well, I mean, I think as Dan said, we're very excited about the opportunity we see in the in the corporate and commercial space. We opened up, we think, about 7% of the UK's business account openings in the first half of this year. We're getting really good momentum into that business. Our offering resonates with that segment so we're looking forward to being able to really lean in and support that important part of the economy, and I wouldn't add anything more to that.

Daniel Frumkin, CEO

Good okay great. Thanks Perlie.

Conference Call Operator

Thank you very much. Our next question comes from Alexei Lougovtsov from Bank of America. Alexei, please go ahead whenever you're ready.

Alexei Lougovtsov, Bank of America

Good morning and thanks for the announcement today. My question is about lock up agreements. You mentioned in the announcement that the debt haircut depends on the lock up agreements. However, I don't see details of what exactly those lock up agreements are. And my second question is when will prospectuses become available?

Daniel Frumkin, CEO

Okay, so I'll do the first one. The first one's really easy. So there's an incentive for the debt holders to get to 75%, so I think that's why the language is in there. But we're at 74.1% and I think 74.3% on the other, on the two pieces. We're so close after trade settle, we're so close to 75% that I wouldn't get hung up on the lock ups. Well, the deal is pretty well papered where we can, it's very well papered so I think we're in really good shape. I wouldn't focus on that. And then there's prospectuses, I think it's a fair question, to be honest. We've been pretty focused and resources have been dedicated to getting the deal done and structured and papered. It's going to take us a little bit of time to get the prospectus out. You know, I would think you're thinking sometime in early to mid November by the time it gets out.

Alexei Lougovtsov, Bank of America

I see. To me, lock up agreements sounded like the holders of new notes would commit to not to sell them in the secondary market.

Daniel Frumkin, CEO

No, no, no. That's not it.

Alexei Lougovtsov, Bank of America

So totally completely free to trade. Right?

Daniel Frumkin, CEO

They will be. I think so. I mean, I'll have to check with the lawyers to make sure there's no short term or short durated. But we did not ask for any exceptional lock up. Yeah.

Alexei Lougovtsov, Bank of America

Okay, so you said 74.9% or 74% of the senior committed and of the Tier 2?

Daniel Frumkin, CEO

Yeah, they're both over 74%. So we had 100% support from both the Tier 2 and the seniors. Yeah. But we could only identify a bit over 74% after trades out of both bonds. So they're both over 74%. So we've just got to find less than 1% of both bonds to get over 75%. Yes.

Alexei Lougovtsov, Bank of America

And then everyone will be taken into the deal, right? 100% will be taken because 75% is sufficient.

Daniel Frumkin, CEO

Exactly. Okay.

Alexei Lougovtsov, Bank of America

Thank you very much and good luck in the process and in the future bank.

Daniel Frumkin, CEO

Thank you so much. I really appreciate your questions.

Alexei Lougovtsov, Bank of America

Thank you.

Conference Call Operator

Thank you. Our next question comes from John Cronin from Goodbody. John, the line is now open. Please go ahead.

John Cronin, Goodbody

Morning, Dan. A few from me please and some points of detail. One, look notably absent from the statement is any commitments in relation to consumer lending growth. Just wondering what your perspective is there for the medium to longer term, do you figure they're the right size at this stage in terms of proportionality? And just your thoughts on that would be helpful. Secondly, can you give us an update on where deposits are now and how they have evolved since the H1 updates? Thirdly, sorry for all the questions.

Daniel Frumkin, CEO

No, no, it's okay.

John Cronin, Goodbody

Third one is AIRB, like you have a £7.6 billion mortgage portfolio at the end of June. Okay. You might sell £3 billion of assets there, so pretty relevant in the context of the other £4.6 billion. Assuming you do achieve a sale, how should we think about that as a possibility for 2024 in our analysis and anything you could say on that would be helpful. And then on the equity raise mechanics, I'm just, look, I know it's not a rights issue, but going off and just doing the basic maths around calculating what a theoretical exercise price would be, getting to about 34p. Spaldy is coming in, though, for £102 million and will have 53%, and currently at market close on Friday I understand they have about 9% so struggling to dovetail that with how they get to 53%. And so anything you can be a bit more specific on with respect to the equity raise, would be helpful. And look a final one, although I probably don't expect much of an answer on this. I mean, you got about 400bps of MREL, if I remember correctly, when you did the asset sale to NatWest three years ago, you're talking a similar quantum in terms of asset sales. Any signs of what might be a reasonable expectation based on your conversations so far. But again, just to reiterate, I appreciate you maybe just can't really say much in terms of speculation at this juncture. Thanks.

Daniel Frumkin, CEO

Okay, so let me go through them, John. I'll try to go through them at a little bit of pace, but I think I'll get it. So the consumer lending growth, actually it's a business we're really happy we bought. It's worked out really well. However, at this point, margins in that business have compressed, pricing in the market has not kept pace with base rate movements. So again, we always say we look at risk adjusted returns on regulatory capital and the risk adjusted returns on regulatory capital in that business have been hindered by the lack of margin expansion in the market. So I doubt it's going to grow. I think it's probably flat to down over the next 18 months or two years. But it's a business we like and we think in a low rate environment does quite well. Deposits, in terms of recent activity, I genuinely appreciate the question and you already know my answer, which is, you know, we don't disclose that information intra period. But I know that is something that people want to know. AIRB, that is a great question, John. So we have not yet received written feedback, we expect it shortly. We've only gotten verbal feedback, so we need to take the written feedback from the Bank of England and digest it and then re-run it through the models and see what reduction in capital it gives us. I know you always modelled sort of we'd end up at sort of 20% to 25% risk weights. I think if we take the feedback back and that's where we end up, we end up with risk weights around 20%, 22%, then my answer to you is yes, I don't think we're far away. I think it's a tidy up exercise and we can get it done in sometime in 2024, 2025. Who knows. I've never really commented on timeline, but it's not a huge exercise. I am worried when we get the written feedback back that it's going to, when we run it through our models, it's going to get us risk weights in the upper twenties or the low thirties. And at that point, John, I think the board would have to reassess whether it's a futile exercise, and given our lack of internal data, we should just pause the programme and reposition the balance sheet. I mean, there are lots of good mid-tier banks that generate really good returns without having AIRB, and we know full well that one of the reasons we were constraining our commercial business and our corporate business is because we weren't sure how they were going to model under AIRB. Well, if we're not going to have AIRB, there are definitely business lines there that we could take advantage of to generate really good returns on a very conservative basis. So the AIRB question is a live question. We just talked about it at the board a couple of weeks ago, and I don't have an answer. We'll get the written feedback. We'll run it through the models. But if we're not chasing a really good savings on our residential mortgage book, I don't know why we do it, because as you know, because you know as well as, if not better than I do, every other portfolio in a bank kind of gets hurt or stays flat under AIRB. You really need to get the benefit out of your residential mortgage portfolio to make up for the impact it has on your commercial and corporate books. So I think it's I don't know, we'll have to wait and see. The equity raise mechanics, the ~~rights issue~~ [correction: firm placing] is at 30p John. So we had 172 million shares outstanding, I think plus or minus. If you multiply that by 30p, I think it's £52 million. I'm doing this in my head right now John, so if I get it slightly wrong, bear with me. But I think that gets you to £52 million. There's £150 million of new equity coming in, which gets you to a total of £202 million. Spaldy's putting in £102 million, which is a little over 50% of the £202 million, but he also owns a little over 9% of the £52 million. And I think if you put those two things together, you end up with sort of 53%. Yes. And the fourth. Sorry just let me finish on the loan sale because it's the last thing. So you'll remember the £3 billion loan sale that we did at par, slightly above par. This loan sale, I mean I'd love to get par, and I hope somebody falls down and hits their head, and I hope they're not listening right now, I hope somebody falls down and hits their head and pays me par. But I think given the rate moves we've had over the last little bit, I think it'll be a below par trade. I gave Grace a pretty good indication of where our tolerance starts to break. So, you know, I think if you factor in a little bit of a discount to par, magically you'll find out 400 basis points is a bit too much. You know, if you factor in a little bit, if you cut it in half and maybe a little bit less, you'll be okay. Yes.

James Hopkinson, CFO

We've given guidance on the RWA obviously.

Daniel Frumkin, CEO

It's £1 billion of RWA that goes away.

James Hopkinson, CFO

And it's earnings accretive as well.

Daniel Frumkin, CEO

Well, I mean, one of the best parts of the trade and somebody wrote it, it wasn't you John because your maths is too good, but somebody else wrote that they didn't think it would help earnings. I don't understand. If we get £3 billion back, that's earning us somewhere around, you know, 3.5% and we put it just in cash at the Bank of England, we pick up 175 basis points on £3 billion. I mean, that's not insignificant from an earnings perspective. Yes.

John Cronin, Goodbody

No, no, not at all. Actually, there's a couple of follow ups, if you don't mind. It's important on the AIRB point. So I really want to just understand. It's like I mean, you've highlighted the lack of internal data. When the Bank of England came out in 2017 with a hard hitting piece around, you know, relaxing requirements around data to include external data for challenger banks, led us to believe from that speech and kind of subsequent musings that, you know, this wasn’t going to mean that you end up with late twenties or early thirties on the risk weights. I mean. I'm sort of struggling with that. And then secondly, on that point, like your total of £30 million, the value of the cost reduction, in my understanding and please correct me if I'm wrong, but like a lot of the investments you've put into cost have been to support an AIRB enabled bank. I mean, can you kind of walk away from some of this now? Like if you can sort of piece that together, that would be helpful. Secondly, on the equity, thanks for the clarification, I must have read that wrongly where I thought the £150 million of new equity was effectively the raise of 30p. So the £102 million is obviously separate from the 30p per share raise. And that sort of dovetails then in terms of the maths around Spaldy. And then finally, look, I forgot to ask initially, but look, cost of risk, is there anything to say in terms of evolution there and the consumer book maybe most particularly, but just generally any kind of update, please?

Daniel Frumkin, CEO

Happy to. So AIRB, listen they also, the Bank of England, published a paper on reference points John, which they used that if you didn't have sufficient internal data, especially about probability possession given default, PPGD, and the use of reference points, which I think is actually something they published, that requires if you don't have enough internal data that they would request that you use their suggested outcomes, yes, for some of the attributes, and then if you layer in conservatism because we don't have internal data, the maths becomes quite onerous. Yes. Listen, when they say oh you have more work to do, it's just because they didn't like our risk weights, John. I mean it's lovely. I mean, maths is maths. It's not hard. I mean, we gave them over a thousand pages. We did every module. I mean, you know, there was no other feedback about anything else. I think they were fine with our stress tests and they were fine with our governance. They're fine with everything else. It's just our models gave us a risk weight that they didn't think it was high enough. I mean, that's what this game is, right? So we just need to kind of figure out whether there's a path through that makes sense for us. In terms of the investment you are right. We have built the balance sheet, we built a £7.5 billion mortgage portfolio in anticipation of getting AIRB. And I think one of the things that we need to decide strategically at the board level over the next handful of months is whether we need to reposition that £7.5 billion of mortgages, make it maybe a bit smaller or a bit more specialist and really start to stretch our legs in commercial and corporate funding. We spend a lot of time, as you can imagine over the last couple of months, modelling all sorts of different scenarios and actually we get to about mid-teens ROTE, medium term, whether we're an AIRB bank or whether we're not an AIRB bank. And so we've just got to decide where we want to stretch our legs. And if we're an AIRB bank, we do more residential mortgages, we do more prime residential mortgages, a bit of specialist. If we're a non-AIRB bank, we do more corporate, more commercial and we do a bit of specialist mortgages. It is back to that tick marks slide and it really brings the tick mark slide alive. We are lucky to have the level of asset optionality we possess at Metro because it really insulates us and allows us to pivot based on risk adjusted returns on regulatory capital. And if the denominator, i.e. regulatory capital changes, well then we change the numerator. And then in terms of risk, you know, it's really weird. We're still not seeing anything. So we're seeing like little bits here and there John. You'll see when we get to the year end, you'll see that the risk metrics have ticked up a bit in unsecured personal, but it's only because the books seasoning because it's all new lending. So, you know, some of that needs to occur. We've seen a little bit in our mortgage portfolio that we acquired before I got here. Somebody bought a mortgage portfolio that's actually just not very good. So we're seeing a bit coming out of that. We've seen some little bits and bobs on the mortgage portfolio, but not too much. So again, we'll get more into that at year end. We tend not to disclose much even at the quarters as you know, but the portfolio is holding up really, really well.

John Cronin, Goodbody

Okay, look, and one final clarification, and sorry for dominating the call for so long, but on the £30 million, the value of cost saved that you articulate, I mean, is that independent of AIRB? So, again, back to my comments.

Daniel Frumkin, CEO

Yes. Yes. You know, completely, John, it has to be independent. We haven't really solutionised it yet John, if I'm honest. Yes. We're starting to think through the implications of it. I'm sorry.

John Cronin, Goodbody

Could there be more in the tank?

Daniel Frumkin, CEO

Maybe. I don't know.

John Cronin, Goodbody

In terms of cost savings?

Daniel Frumkin, CEO

Yeah, maybe. I don't know. £30 million seems like a big number. And I want to be really clear. It's not £30 million off the 2023 number because I think we guided we'd have kind of mid-single digit growth in costs next year. I think that was the guidance we gave at half year. I can't remember. We said I think it was mid-single digit and so low to mid or mid. And so the reality is, is that you need to kind of take 2023 up and then take £20 million of it off in 2024 and then we'll take another further £10 million off as we get into 2025 because, you know, yes, I think we need to really rethink what we do.

John Cronin, Goodbody

Okay, fair. Thanks.

Daniel Frumkin, CEO

Thanks, John.

Conference Call Operator

Thank you very much. Our next question comes from Corinne Cunningham from Autonomous. Corinne your line is now open. Please go ahead.

Daniel Frumkin, CEO

Hey, Corinne, how are you?

Corinne Cunningham, Autonomous

Good morning. Very well, thanks. And thank you for the question.

Daniel Frumkin, CEO

And do me a favour, do me a favour. Thank Chris for his cameo last week. It was nice to see him pop back up.

Corinne Cunningham, Autonomous

Okay. I will do, I think he might be listening. So I'm sure he's hearing you ear to ear, so to speak. A couple of techie ones from me. First one, just in terms of do you expect to be profitable in Q4 after restructuring costs and then whatever you're going to book on the mortgage sale? Another one is just on the capital ratio that I assume we're still using phased in ratios in the 13% etc.. Do you move to full phase out, or fully phased in I should say, on 1 Jan? And is that still about 70 bps difference? And then last question is on TFSME refinancing. Would part of the mortgage disposal, would that be expected to go towards TFSME refinancing? If not, what are your plans there? Thank you.

Daniel Frumkin, CEO

So I'll start at the end and then I assume the phase in you're talking about the add back we get for ECL. Yes. That thing that went back to COVID. Yes. Okay fine. So yes, it assumes it phases out. Yes. It is in, the 30 June numbers are as they were i.e. with a bit of the phase in left and then the rest rolls off. The TFSME, it's a really good question. You're the first person to ask it. And I think it's, so listen, I think the liquidity we generate is likely to end up at the Bank of England in cash for the near term, whether we use it to pay back the Bank of England or whether we put it with them in cash, it's the exact same interest rate. And so we're having that debate internally. Clearly, if we use it to pay off TFSME, it probably helps NIM a bit more if we're honest. So it's a conversation we're having. I think it's a really clever observation. Yes. But I don't know the answer to it, if I'm honest, because, you know, we don't have the cash yet. We're just not done. So we're really just debating it. We talked about the phase in in the capital ratios. I think it's lovely that you've asked about profitability for quarter four, but it's not guidance we're going to provide. You know, again, quarter three, we did say on an after tax basis we made a bit of money, not a lot, but it was a positive number. We did talk about the fact that the business had lost a bit of momentum because of a bit of deposit outflow in the first half of the year, as everybody saw in the marketplace. And I think everybody was modelling that the second half of the year would be significantly less profitable than the first half of the year. I don't know that that changes. I think what does change as we start to get into 2024 is we can start to deploy the growth capital we just got our hands on and really start to transform the P&L of the bank. But since it's not even going to close until December, there's no way I can use the growth capital to transform the fourth quarter. Yeah, so I think I don't really have an answer for you on quarter four. Well, even if I did, I wouldn't tell you. But I think there's a lot of moving pieces. What I am really confident in is beyond 2024 because we now have the growth capital necessary to really stretch our legs.

Corinne Cunningham, Autonomous

Thank you. one last one which you're probably not going to appreciate just on your on your Pillar 2 requirements. They've been gradually kind of coming down, do you expect that that would go into reverse and start to go up?

Daniel Frumkin, CEO

I have no idea. No idea. So, you know, the reality is, is we need to spend some time with the regulator. You know, they do periodic C-SREPs, as everybody knows. You know, we'll get through that process when our next C-SREP is. And I'm not going to tell you when that is. And we'll see. We'll see where it goes. I have no idea. I think I've learned a valuable lesson not to speak for the regulator. And I learned it years and years ago. And I'm not going to start now. It's really within their discretion. Yes.

Corinne Cunningham, Autonomous

Thanks very much.

Conference Call Operator

Thank you. As a reminder, if you'd like to ask a question, please press star followed by 1 on your telephone keypad. Our next question comes from Aman Rakkar from Barclays. Please go ahead whenever you're ready. Your line is now open.

Aman Rakkar, Barclays

Hi, Dan. Thanks very much. Thanks very much for the update and thanks for taking the questions. Sorry, I've got two. I'm revisiting topics that have already been addressed. But I think there's a point of clarification on both I just want to get to. Can I just check on this mortgage sale, are you registering interest at the kind of commercial terms that you've alluded to or is this a kind of hope and aspiration.

Daniel Frumkin, CEO

No, we're registering interest. No, no. We have genuine interest, yes genuine interest across a range of names, not one dissimilar to what's on your paycheque.

Aman Rakkar, Barclays

That's great to know. I guess I was just noting, you know, you did a £3 billion mortgage sale in 2020 and you broadly speaking sold that at par value and it had a weighted average rate of 208 basis points. So, you know, that would have been quite an attractive fixed rate asset portfolio. But you know, given interest rates are so much higher, there has to be a pretty significant negative fair value on this portfolio on acquisition.

Daniel Frumkin, CEO

No. So I think you need to think a few things through actually. Right. So again, if you're doing any kind of an NPV model, you need to figure out how long they're durated for, when the buyer might be able to get access to re underwrite the credit and then be able to reprice it up. Yes. So you're right, if we sold, you know, mortgages that had 5 year duration from today yielding a little under 4%, the haircut might be bigger. If we sold mortgages that had an 18 month duration and were a little under 4%, the market would be different. So I think you need to factor that in your thinking. And then the second thing is that you've got to factor in the ability of certain financial institutions to be able to have grown their mortgage book. I think it was actually, I can't remember, I think it was Perlie’s question actually about whether we were confident in our ability to grow assets and confident in our ability to get the loan growth given the compression in the mortgage market. So I think if I ran a big mortgage shop and I was going to have to show that I was going backwards from an asset perspective, I think I might be motivated to try to do a transaction. So, I think there's a lot of factors that go in there. So, and again, if we don't sell it, I don't really care, we'll just let it run off. Yes. It doesn't really matter to me. It's just the pace at which we could reposition the balance sheet is attractive because we'd like to crack on with it. But if we have to wait for it to roll off ourselves, well, we'll take the margin uplift when it rolls off. It doesn't really matter. Yes.

Aman Rakkar, Barclays

Thanks very much for that. I mean, that's a really helpful bit of colour. The second was just on costs. Sorry if I've kind of misheard you. I think there's been a kind of nod a couple of times towards a 2024 cost number. I think I heard actually in your prepared remarks or at some point during your presentation that you know, the £30 million of cost savings is versus a 2024 cost number that some kind of investors that have had, you know, had access to that number or have seen that number. And forgive me if I've missed guidance that you've issued at H1 or something, but I mean, can you just clarify that point? So is there a 2024 cost your pitching for?

Daniel Frumkin, CEO

Yes. Yes. So, sorry, because I know it's important for the models and I think we have a session later today with analysts and stuff too as well. So the reality is, is that I think when we stood up at the half year, we showed a negative little red arrow going up about cost and I think with the voice overlay was I think something along with inflationary pressures, low to mid single digit increases should be expected.

I think that was the language we used. And so I think if you take the £533 million or whatever, £534 million, whatever the number was at the half year and you gross it up a little bit by, you know, somewhere between low single to mid-single digits. And then if you then took £30 million off of that, that's probably closer to a better answer than just taking £30 million off of the 2023 number. Yes.

Aman Rakkar, Barclays

Perfect. Thank you so much. And thanks so much for the detail that you've given. It's really helpful.

Daniel Frumkin, CEO

Thank you.

Conference Call Operator

Thank you. We have time for one more question, and that comes from Daniel Crowe from Goldman Sachs. Daniel, your line is now open, please proceed.

Daniel Frumkin, CEO

Hi, Daniel.

Daniel Crowe, Goldman Sachs

Hi there. Good morning. You've answered most of my questions, just a couple of points of clarification. At the extension on the senior, I assume that's going to match the £175 million coming in. So a six non-call five.

Daniel Frumkin, CEO

What we did is we're just grossing up the senior, to make it as simple as we could, given the time window we had the £350 million is going to become a five and a quarter, £525 million. It's going to go from £350 million to £525 million. So the terms will be exactly the same because it'll be the exact same thing.

Daniel Crowe, Goldman Sachs

Ok. So it becomes six non-call five?

Daniel Frumkin, CEO

It's a little bit, it's actually like a five and a half non-call four and a half I think technically, because I think it's like April of 2028 or something. Do you know what I mean?

Daniel Crowe, Goldman Sachs

Yeah, yeah, that's no problem. And then the Tier 2, I mean, I think it's pretty clear, but just checking, the £100 million, they're effectively contributing to the CET1, they don't get anything apart from, I guess, not getting burnt.

Daniel Frumkin, CEO

I have nothing to add to that comment, Daniel.

Daniel Crowe, Goldman Sachs

And then just finally on the TFSME. I know you kind of talked around it there. Just given the mark to market loss on the portfolio, I know you said you previously matched TFSME to you're your bond portfolio. Is there a bit of an asset liability match there?

Daniel Frumkin, CEO

Maybe, we don't really, I mean that was prior management. We don't really look at it that way, if I'm honest. Listen, we have tons of liquidity. Yes. I mean, just tons. Yes. And so, so we've held on to TFSME just for a level of prudence. We're either going to repay it from the liquidity we generate from our deposit book, which continues, you know, which I think everybody's seen, or we're going to potentially use the asset sale proceeds to repay some of it. We're not really all that worried. We just think in an uncertain marketplace, having extra liquidity just makes sense and it's sort of income neutral and NIM dilutive. Right. And we basically take it and put it back with the bank. I mean, it's not, it's a relatively straightforward trade, but it does give us a bit of a bit of insulation. But it is really NIM dilutive. So I don't know we're kicking it around, but there's no, we're not worried about how we get the liquidity to pay it back because we have so much excess liquidity. Yes.

Daniel Crowe, Goldman Sachs

Yeah. No problem, I mean I agree that the rates at which they are now, they won't make a huge amount of difference. And then just a final clarification on the mortgage sale. You were kind of alluding to it there, but I assume to reduce day one capital loss, I mean, you effectively want to match the assets, well, I guess reduce the duration and bring them more up to the kind of levels the rates are now or effectively just sell off the shorter dated.

Daniel Frumkin, CEO

Spot on so. So if you start looking at swap curves instead of looking at base rate, you start to probably come out with different maths. Yes, so that's spot on. And then I think for us, you know, it's capital accretive on a ratio perspective because again, we're going to take a bit of a hit in terms of, you know, we're not going to sell it at par, so obviously that means it comes out of CET1. But we do have a big reduction in RWA. So it is ratio accretive and we get earnings uplift. So, you know, whether you make it back in earnings or not depends on what price we get. So it's that and you are right when you're trying to figure out the price, I think everybody kind of thinks, oh, a base rate of five, no, no, look at the short durated swaps. Yes.

Daniel Crowe, Goldman Sachs

Okay, Perfect. That's great. Thanks very much.

Daniel Frumkin, CEO

Yeah no worries. Thank you Daniel. I appreciate it.

Conference Call Operator

Thank you. We have no further questions so I will now hand back to Daniel for any closing remarks.

Daniel Frumkin, CEO

Listen, just first thank you all for the time. I genuinely appreciate it. I think I just want to sort of reiterate what this means for Metro going forward and how it repositions us to genuinely take advantage of the unique franchise we have built. And we are very excited about the prospects this gives Metro going forward and we're very excited about that core profitability we will be able to generate and the capital generation and how we can deploy that capital generation. All the capital we generate, we know we have ability to redeploy it in accretive ways. So again, thank you all for the time and thank you all for your support of Metro. Take care.